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Supreme Court of the United States

October Term, 1932.

No. 322.

THE MASSACHUSETTS MUTUAL LIFE INSURANCE COMPANY,
(A Corporation), Petitioner,

vs.

THE UNITED STATES.

BRIEF FOR PETITIONER.

GUY PATTEN,
Counsel for Petitioner.

A. R. SERVEN,
JOHN W. SMITH,
Of Counsel.

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vs.

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BRIEF FOR PETITIONER.

I.

Opinion of the Court Below.

The opinion of the Court of Claims (R. 16) is reported in 59 Fed. (2d) 116.

II.

Jurisdiction.

1. The judgment to be reviewed is that of the Court of Claims, dated May 31, 1932 (R. 19). Petition for writ of certiorari was filed August 26, 1932, and the petition was granted November 7, 1932 (R. 21).

2. The jurisdiction of this court is based upon Section 3 (b) of the act approved February 13, 1925 (43 Stat. 939), and Rule 38, 5 (b), (c) of the Revised Rules of this court, adopted June 8, 1925; in particular that part of the Rule citing as cases for granting a writ of certiorari a case where the lower court has decided an important question of substance relating to the construction of a statute of the United States, which has not been, but should be, settled by this court.

III.

Statement of the Case.

The object of this proceeding is to obtain a review of a judgment of the Court of Claims, dated May 31, 1932 (R. 19), denying to petitioner, a life insurance company, the right to deduct from gross income, in the determination of its Federal income tax liability for the year 1926, all interest accrued and credited to its policyholders during said year subject to withdrawal on demand but not actually withdrawn by them, on dividends left with it to accumulate at interest.

The petitioner, a Massachusetts corporation, during the year 1926, and for many years prior thereto, was engaged in the business of making and selling life insurance on the mutual level premium plan in Massachusetts and other states of the United States, and as such was subject to the Revenue Act of 1926 providing for the payment of income taxes for said year. (R. 11).

The policy contracts issued by the petitioner provide that such policy will participate annually in the distribution of the surplus funds of the company; that such dividends, at the option of the insured, among other things, will be paid in cash or may be left with the company to accumulate, subject to withdrawal on demand; and that dividends left to accumulate will be credited at the end of each policy year with interest at such rate, not less than three per cent, as may be determined by the directors, which interest is subject to withdrawal on demand. (R. 14, 15).

During the year 1926, the period involved in this case, each policyholder leaving dividends with the petitioner to accumulate was given credit in his individual account with the petitioner for his respective part of the interest which accrued thereon during said year and a regular form notice of the amount so credited was mailed to each such policyholder prior to the close of the year. Such interest was payable on demand and the policyholder was so advised. It was the practice of the petitioner to accept

such notice on demand for cash payment of the amount shown therein. (R. 11).

In the determination of petitioner's income tax liability for the year 1926 and the adjudication of its refund claims for said year, the Commissioner of Internal Revenue refused to allow petitioner to deduct from gross income the sum of $544,964.40, which was the amount of interest accrued and credited to its policyholders during said year but not actually withdrawn by them on dividends left with it to accumulate, and which (R. 11) petitioner had deducted in its tax return for said year. Instead thereof, said Commissioner allowed petitioner a deduction of $248,405.97, which was the amount of interest on dividend accumulations actually withdrawn or surrendered by its policyholders during said year, irrespective of the year of origin. The major portion of this item originated in prior years. (R. 12, 13).

There is no question here in regard to the deduction of interest when actually withdrawn or surrendered by the policyholder, as the petitioner is not claiming it is entitled to deduct interest when accrued and credited subject to withdrawal on demand and again when actually withdrawn. (R. 10, 11).

Petitioner claims it is entitled to recover the tax paid, with interest thereon as provided by law, on the difference between said amount claimed in its tax return ($544,964.40) and the

amount allowed by said Commissioner on a different basis, ($248,405.97), as a deduction, said difference ($296,558.43) representing the amount of interest accrued and credited to its policyholders for said year which it has not received as a deduction and which has substantially increased petitioner's income tax liability for said year.

IV.

Specification of Errors.

1. The Court of Claims erred in holding that interest accrued and unconditionally credited to policyholders during the tax year subject to withdrawal on demand, in compliance with the terms of the policy contracts, was not deductible from gross income for such year under the provisions of the tax act unless it was actually withdrawn by the policyholder during such tax year.

2. The Court of Claims erred in holding that petitioner's right under the tax act to the deduction of the interest involved here was dependent upon the method of accounting employed.

3. The Court of Claims erred in holding that in the enactment of subdivision (8) of Section 245 (a) of the Revenue Act of 1926 Congress did not intend to make an exception, in the case of life insurance companies, to the general rule that deductions from gross income should be determined in accordance with the method of accounting employed.

4. The Court of Claims erred in holding that to allow the deduction of interest accrued and credited to policyholders during the tax year subject to withdrawal on demand, in the case of life insurance companies taxable under the special provisions of the Revenue Act relating to them, would destroy the distinction between the paid and the accrued methods of accounting, or that such distinction is applicable to this case.

5. In the construction of the statute and its relation to the facts disclosed, the Court of Claims erred in its failure to distinguish between purely an accrued item and an item which, immediately upon accrual, is set aside to the policyholder subject to withdrawal on demand.

6. The Court of Claims erred in holding, either directly or by analogy, that subdivision (8) of Section 245 (a) of the Revenue Act of 1926 is affected by the provisions of Section 200 (d) of said Act.

V.

ARGUMENT.

Statutes and Regulations.

The pertinent provisions of the Revenue Act of 1926 and the Regulations of the Treasury Department thereunder are set forth in full in the Appendix hereto (p. 25). The following appears therein:

"Section 245 (a). In the case of a life in-

surance company the term 'net income' means the gross income less—

* * * * * * * * *

(8) All interest paid or accrued within the taxable year on its indebtedness, except on indebtedness incurred or continued to purchase or carry obligations or securities (other than obligations of the United States issued after September 24, 1917, and originally subscribed for by the taxpayer) the interest upon which is wholly exempt from taxation under this title." (p. 33).

The Regulations.

Regulations 69, pertaining to the Revenue Act of 1926, provides by Article 685, subdivision (3), that—

"The deduction allowed by Section 245 (a) (8) for interest on indebtedness is the same as that allowed other corporations by Section 234 (a) (2) (See Articles 561 and 121) but this deduction includes item 18 of the disbursement page of the annual statement of life companies to the extent that interest on dividends held on deposit and surrendered during the taxable year is included therein. Dividends left with the company to accumulate at interest are a debt and not a reserve liability. (p. 35).

Summary of Argument.

A. The statute involved is clear and unambiguous and the decision below is in conflict therewith.

1. The statute being unambiguous, Treasury Regulations in conflict therewith cannot be given the force and effect of law.

B. Under the statute, the right to the deduction involved is not dependent upon the method of accounting employed.

1. The deduction claimed, under the facts, does not destroy the distinction between the paid and the accrued methods of accounting.

2. In the construction of the statute in its relation to the facts disclosed, the Court of Claims erred in its failure to distinguish between purely an accrued item and an item which, immediately upon accrual, is set aside to the policyholder subject to withdrawal on demand.

3. Section 200 (d) of the statute is not applicable to the sections relating to life insurance companies.

A.

The statute involved is clear and unambiguous and the decision below is in conflict therewith.

It is the position of petitioner that, in the determination of its income tax liability for the year 1926, it is entitled to the deduction from gross income in the computation of net income of all interest accrued and credited to its policyholders during the taxable year on dividends left to accumulate at interest, because the statute in clear and unambiguous terms so provides. Sec-

tions 242 to 245, inclusive, of the Revenue Act of 1926 relate solely to life insurance companies and constitute a special statute for determining the income tax liability of this class of taxpayers. These sections of the statute provide: (App. p. 31).

> "Sec. 244 (a). In the case of a life insurance company the term 'gross income' means the gross amount of income received during the taxable year from interest, dividends, and rents."
>
> "Sec. 245 (a). In the case of a life insurance company the term 'net income' means the gross income less—
>
> (1) The amount of interest received during the taxable year which under paragraph (4) of subdivision (b) of section 213 is exempt from taxation under this title.
>
> * * * * * * * * * * *
>
> (3) The amount received as dividends (A) from a domestic corporation other than a corporation entitled to the benefits of section 262 and other than a corporation organized under the China Trade Act, 1922, * * *.
>
> * * * * * * * * * * *
>
> (5) Investment expenses paid during the taxable year, * * *.
>
> (6) Taxes and other expenses paid during the taxable year exclusively upon or with respect to the real estate owned by the company, * * *.
>
> * * * * * * * * * * *

(8) All interest paid or accrued within the taxable year on its indebtedness, * * *.

The other subdivisions of this Section relate to certain deductions not involving receipt or payment. Subdivision (2) provides for a compensating deduction as against gross investment income of 4 per centum of the mean of reserve funds held by the company for the benefit of its policyholders, and subdivision (4) of 2 per centum on dividends the payment of which is deferred. Subdivision (7) provides for depreciation on property; and subdivision (9) (b) provides that the company shall carry into gross income the rental value of space occupied by it in an amount not less than a sum which in addition to any rents received from other tenants will provide a net income of 4 per centum of the book value of the real estate so owned or occupied, as a compensating condition for the allowance of taxes, expenses and depreciation on such real estate.

The statute indicates that Congress undertook to deal with life insurance companies specifically, and in practically all respects differently from other classes of taxpayers. The words "paid or accrued," as they appear in the provision for the deduction of interest, must be construed in connection with the other provisions so as to give an harmonious effect to the whole plan of Congress for determining the taxable net income of this class of taxpayers. (*United States v. Landram*, 118 U. S. 81; 30 L. ed. 58; *Mason v. United*

States, 260 U. S. 545; 67 L. ed. 396; *Lawrence v. Allen*, 7 How. 785; 12 L. ed. 914; *Peck v. Jenness*, 7 How. 612; 12 L. ed. 841; *Bernier v. Bernier*, 47 U. S. 242; 37 L. ed. 152).

The foregoing plan of dealing with life insurance companies was first adopted by Congress in the Revenue Act of 1921 (42 Stat. 227), approved November 23, 1921. That Act likewise contained the same difference of expression with reference to the provision for the deduction of interest, and that of other deductions, as appears in all the later Revenue Acts. Prior to the passage of the Revenue Act of 1921, the Treasury Department, on April 9, 1921, had ruled that life insurance companies were required to make their returns on the cash receipts and disbursements basis as distinguished from an accrual basis, as being in accordance with the method of accounting regularly employed by such companies, and such Regulation was duly published (R. 12, Find. 2). That Congress was familiar with the conditions of the business and said ruling of the Treasury Department is evidenced by the provisions of the Revenue Act of 1921, and like provisions in all subsequent Acts. The definite and specific terms of the legislation which followed emphasize the significance of the provision for the deduction of interest "paid or accrued." When it is considered that the business of life insurance companies is that of selling life insurance, evidenced by written contracts, then the findings of the Court

below covering the terms of those contracts, the practice and method employed in transacting such business with the policyholders, likewise familiar to it, explains why Congress provided for the deduction of interest in different terms than those relating to other items of receipt and disbursement. It was conforming its legislation to the conditions of the business. All interest as it accrued was in practice, in fact and pursuant to contract credited under conditions equivalent to payment. It was set apart to policyholders subject to their demand. Its deduction from gross income in connection with the other provisions reflects the correct net result of the operations for the taxable year without involving transactions for any prior or subsequent year. Congress adopted the plan of taxing life insurance companies on the basis of their investment income from interest, dividends, and rents, with suitable deductions for expenses properly chargeable against such investment income. In view of this plan it is logical that Congress should provide for the deduction of all interest accrued within the taxable year, whether actually paid or not. It is deductible if paid or if accrued within the taxable year, but not both, hence the term "paid or accrued." When regard is had to the other provisions of the Act relating to life insurance companies, we find no language which in any manner qualifies this provision. We believe this construction gives due weight, as any construction

must if possible, to all the words of the statute, and is in harmony and consistent with the other provisions and the plan as a whole for determining the taxable net income of life insurance companies. (*Washington Market Co. v. Hoffman*, 101 U. S. 112; 25 L. ed. 782; *Brown v. Duchesne*, 19 How. 183; 15 L. ed. 595; *United States v. Boisdore*, 8 How. 113; 12 L. ed. 1009).

Treasury Regulations Not Controlling.

It is urged by the Government that the Treasury Regulations, in accordance with which the Commissioner determined (and which was approved by the court below) that only interest actually paid was deductible, are controlling in this case. It is a familiar principle that in the interpretation of a doubtful or ambiguous statute the interpretation of those charged with its administration is entitled to great weight. But, it is respectfully submitted that principle is not applicable here. There is no ambiguity in the provision of Section 245 (a) (8) of the Act for the deduction of interest "paid or accrued." Obviously, Article 685 when read in connection with the references therein contained is intended to provide that the deduction allowed life insurance companies by Section 245 (a) (8) for interest on indebtedness is dependent upon the method of accounting employed, with the further specific limitation that interest on dividends held on deposit may not be deducted unless actually withdrawn

or surrendered by the policyholder during the taxable year. As heretofore pointed out, it is not believed that the provisions of the Revenue Act (Sections 242 to 245, inclusive), are susceptible to the restricted interpretation placed thereon in the foregoing Treasury Regulations, unless the word "accrued," in the provision for the deduction of interest on indebtedness, be treated as superfluous, void or insignificant. Such treatment would violate the well established rule that effect must be given to all the words of a statute, when this is possible without conflict. (*United States v. Gooding*, 12 Wheat. 460; 6 L .ed. 693; *Montclair Twp. v. Ramsdell*, 107, U. S. 147; 27 L. ed. 431; *Early v. Doe, ex. dem. Homans*, 16 How. 610; 14 L. ed. 1079; *Wilmot v. Mudge*, 103 U. S. 217; 26 L. ed. 536).

The distinction between *McCaughn v. Hershey Chocolate Co.*, 283 U. S. 488, which involved a doubtful or ambiguous statute, *Fawcus Machine Company v. United States*, 282 U. S. 375, and *Brewster v. Gage*, 280 U. S. 327, in which the court found that the regulations were not in conflict with or did no violence to the letter or spirit of the Act, and the prinicples involved here is clearly reflected in *Iselin v. United States*, 270 U. S. 245, 250, 251, in which the court said:

> "Congress undertook to accomplish its purpose by dealing specifically, and in some respects differently, with different classes of tickets and with tickets of any one class un-

der different situations. The particularization and detail with which the scope of each provision, the amount of the tax thereby imposed, and the incidence of the tax, were specified, preclude an extension of any provision by implication to any other subject. The statute was evidently drawn with care. Its language is plain and unambiguous. What the government asks is not a construction of a statute, but, in effect, an enlargement of it by the court, so that what was omitted, presumably by inadvertence, may be included within its scope. To supply omissions transcends the judicial function."

"The government calls attention to the fact that, as early as October 24, 1919, the Commissioner of Internal Revenue made the ruling pursuant to which the tax here in question was assessed; that on March 22, 1920, the Attorney General sustained that ruling; that the provisions here in question were re-enacted without substantial change in the Revenue Act of 1921 * * * and the Revenue Act of 1924 * * *; and that the administrative practice adopted in 1919 has been steadfastly pursued. It suggests that these facts imply legislative recognition and approval of the executive construction of the statute. But the construction was neither uniform, general, nor long continued; neither is the statute ambiguous. Such departmental construction cannot be given the force and effect of law."

This distinction is likewise observed in *Louisville & Nashville Railroad Co. v. United States*, 282 U. S. 740, wherein the court says:

"The act has been repeatedly amended, and has been re-enacted, without any change directed to the correction of this practice. It is strongly urged that in the light of these circumstances the administrative construction should be determinative. The principle is a familiar one that in the interpretation of a doubtful or ambiguous statute the long-continued and uniform practice of the authorities charged with its administration is entitled to great weight, and will not be disturbed except for cogent reasons. * * *. But that principle does not go far enough to control the decision here. There is no ambiguity in the requirement of Section 6 (1) of the act that its provisions as to published tariffs 'shall apply to all traffic, transportation, and facilities defined in this act.' "(757)

"Long continued practice and the approval of administrative authorities may be persuasive in the interpretation of doubtful provisions of a statute, but cannot alter provisions that are clear and explicit when related to the facts disclosed. A failure to enforce the law does not change it." (759)

B.

Under the statute, the right to the deductions involved is not dependent upon the method of accounting employed.

As above noted, the provisions of Sections 242 to 245, inclusive, of the Revenue Act are definite and inflexible. Under those provisions there is no basis upon which a life insurance company can be taxed except that detailed in the statute. The method of accounting regularly employed by

such companies, known to Congress, would seem in itself to explain why these provisions relating to life insurance companies are definitely fixed, while the provisions of Sections 213 and 214 (App. p. 26, 27) relating to individuals, and Sections 232, 233 and 234, (App. p. 28, 29) relating to corporations other than insurance companies, whose methods of accounting may widely differ, are expressly dependent upon the method employed. These fixed provisions relating solely to life insurance companies are not subject to any change in accounting methods which such a company might adopt, hence are not dependent upon the method employed. It is believed that the words "paid or accrued" should be construed in connection with the provisions relating solely to life insurance companies, instead of other and different parts of the Act. This distinction is observed in *Atlantic Cleaners & Dyers v. United States*, 286 U. S. 432, 433; 76 L. ed. 1204, wherein the court says:

> "Where the subject matter to which the words refer is not the same in the several places where they are used, or the conditions are different, or the scope of the legislative power exercised in one case is broader than that exercised in another, the meaning well may vary to meet the purposes of the law, to be arrived at by a consideration of the language in which those purposes are expressed, and of the circumstances under which the language was employed."

The deduction claimed, under the facts, does not destroy the distinction between the paid and the accrued methods of accounting.

By the same measure, the question whether the allowance of interest accrued and credited subject to demand under Section 245 (a) (8) would destroy the distinction between the paid and the accrued methods of accounting, not only becomes irrelevant, but Congress evidently considered it would not. This provision for the deduction of "All interest paid or accrued" is not so much an exception, in the case of life insurance companies, to the general rule that deductions from gross income should be determined in accordance with the method of accounting employed, as it is a provision based by Congress upon the known conditions of the business. The word "accrued" cannot be read out of the statutes. If it is read as depending upon the method of accounting employed it can never have any meaning or operative effect under any circumstances, which amounts to the same thing, because the statute is definite and inflexible that all items of receipt and all other items of deduction involving payment, shall be returned on the cash basis. It is the purpose of taxing statutes to require returns that clearly reflect correct taxable income. While it is a reasonable construction of the law, when applied to a case coming within its provisions, that the same method be applied to both sides of the ac-

count, (*United States v. John J. Mitchell*, et al., 271 U. S. 9, at page 12; *United States v. Anderson*, 269 U. S. 422; *W. S. Barstow & Co. v. Bowers*, 2d C. C. A. 15 Fed. (2d) 75, 78), the above cases which laid down this principle were dealing with statutes and regulations under which the taxpayer might make his return on either the "paid" or "accrued" basis, depending upon the method of accounting employed by him. No such condition is possible under the provisions relating to life insurance companies. But in their case, the deduction of all interest accrued and credited to policyholders during the taxable year does meet the rule of consistency and reflects the true net income of the company for such year, because such interest is actually set aside to the policyholders and thereafter is subject to their demands (R. 11, Find. 1) and not that of petitioner.

In the Report of the Committee on Ways and Means on H. R. 8245, (Revenue Bill of 1921), Report No. 350, p. 14 (Mr. Fordney), 67th Congress, 1st Session, it was said:

> "Life Insurance Companies.
>
> Sections 242-246: The provisions of the present law applicable to life insurance companies are imperfect and productive of constant litigation. Moreover, the taxes paid by life insurance companies under the income tax are inadequate. It is accordingly proposed in lieu of all other taxes to tax life insurance companies on the basis of their investment income from interest, dividends,

> and rents, with suitable deduction for expenses fairly chargeable against such investment income, * * *."

The deduction of interest on the basis here claimed being necessary to correctly reflect the true net income of a life insurance company, Congress so provided.

It is submitted that the deduction of interest set aside to policyholders subject to their demand is essential in order to determine the current year's income of the company and to avoid the taxation to it of a portion of its gross investment income which is not actually realized as income within the year.

> Distinction between an accrual and an accrual set aside subject to withdrawal on demand.

The provisions of the statute become clear and explicit when related to the facts disclosed. In the construction of the statute, and especially in its relation to the facts disclosed, it is believed the court below erred in its failure to distinguish between an accrual in the usual sense of the term and an accrual unqualifiedly credited subject to withdrawal on demand. It is this distinction, as heretofore pointed out, which we believe explains why Congress differentiated between the deduction for interest and the other deductions provided for in Section 245, *supra.*

In *Hadley v. Commissioner of Internal Revenue,* (36 Fed. (2d) 543), the Court of Appeals of

the District of Columbia, in affirming a decision of the United States Board of Tax Appeals (6 B. T. A. 1031), held that profits credited to stockholders of a corporation and unqualifiedly subject to their demand are constructively received when credited and constitute taxable dividends to the stockholders. In that case the court draws the exact distinction contended for by petitioner in the case at bar when it says:

> "It does not clearly appear whether the taxpayer rendered his return on a cash or accrual basis, but we think this is not material, since the mere credit of his account with the earnings constituted an accrual, (*United States v. Anderson*, 269 U. S. 422; T. D. 3839, C. B. V.-I, 179). However, according to the practice of the Department, the amounts were constructively received when credited.
>
> "* * * This distinction between receipt and accrual must be kept in mind. Income may accrue to the taxpayer and yet not be subject to his demand or capable of being drawn on or against by him.
>
> "Clearly, under this rule, the earnings set aside in the present case must be construed as a receipt instead of an accrual, since the share of the earnings belonging to the appellant was not only placed to his credit on the books of the corporation, but was brought unqualifiedly subject to his demand. It was money available for his use as much as if it had been placed in his bank account subject to check."

In *Commissioner of Internal Revenue v. Bingham*, (35 Fed. (2d) 503), the Circuit Court of Appeals for the Sixth Circuit held that dividends actually received in 1923 by a stockholder whose books are kept on a cash receipts and disbursements basis are nevertheless required to be included in gross income in 1922, when they were declared and unqualifiedly subject to his demand.

The same principle is affirmed in *Charleston & Western Carolina Railroad Company v. Burnett*, 50 Fed. (2d) 342, and *Chicago, Rock Island & Pacific Railroad Company v. Commissioner* (Circuit Court of Appeals, Seventh Circuit, 47 Fed. (2d) 990).

Section 200 (d) of the statute is not applicable to the sections relating to life insurance companies.

Section 200 (d) of the Revenue Act of 1926 (App. p. 25) provides:

> "(d) The terms 'paid or incurred' and 'paid or accrued' shall be construed according to the method of accounting upon the basis of which the net income is computed under section 212 or 232. The deductions and credits provided for in this title shall be taken for the taxable year in which 'paid or accrued,' or 'paid or incurred,' dependent upon the method of accounting upon the basis of which the net income is computed under section 212 or 232, unless in order to clearly reflect the income the deductions or credits should be taken as of a different period."

Section 200 (d) by its own terms expressly limits its application to those taxpayers whose net income is computed under Section 212 or 232.

Section 212 (App. p. 25) deals with individuals and section 232 (App. p. 28) deals with corporations other than insurance companies. Both these classes of taxpayers are allowed to make their returns on either the paid or accrued basis. The statute allows them to deduct (alike in Section 214 and 234) "all * * * expenses paid or incurred during the taxable year," "all interest paid or accrued within the taxable year," "taxes paid or accrued within the taxable year." Congress therefore provided by Section 200 (d) that "The terms * * * 'paid or incurred' and 'paid or accrued'" shall be construed according to the method of accounting upon the basis of which the net income is computed under Section 212 or 232. Section 200 (d), so far as the provisions relating to life insurance companies are concerned, has no subject matter upon which to operate. Hence Congress, acting advisedly, limited the operation of Section 200 (d) to Sections 212 and 232. This leaves Sections 242 to 245, inclusive, clear and unambiguous and Section 200 (d) is an aid to such clarity. Likewise, Section 200 (d) when read in connection with said provisions relating to life insurance companies would seem to exclude any interpretation that the right to the deduction of interest on indebtedness involved here is dependent upon the method of ac-

counting employed. This distinction is observed in *United States v. Mitchell, supra.* In that case the net income of the taxpayer was computed under Section 212 of the applicable Revenue Act, hence the provisions of Section 200 were invoked.

CONCLUSION.

Inasmuch, then, as the statute in clear and unambiguous terms provides for the deduction of interest accrued; since the statute nowhere contains any limitation or qualification of this provision; and since the method provided by the statute, when considered in its relation to the facts disclosed, if followed, reflects the correct net results of the operations for the taxable year, it is believed that the judgment of the court below should be reversed.

Respectfully submitted,

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APPENDIX.

The Statutes.

The pertinent provisions of the Revenue Act of 1926 read as follows:

TITLE II—INCOME TAX.

PART I.—GENERAL PROVISIONS.

Definitions.

Sec. 200 (44 Stat 10). When used in this title—

* * * * * * * * *

(d) The terms "paid or incurred" and "paid or accrued" shall be construed according to the method of accounting upon the basis of which the net income is computed under section 212 or 232. The deductions and credits provided for in this title shall be taken for the taxable year in which "paid or accrued," or "paid or incurred," dependent upon the method of accounting upon the basis of which the net income is computed under section 212 or 232, unless in order to clearly reflect the income the deductions or credits should be taken as of a different period.

Net Income of Individuals Defined.

Sec. 212. (44 Stat. 23). (a) In the case of an individual the term "net income" means the gross income as defined in section 213, less the deductions allowed by sections 214 and 206.

(b) The net income shall be computed upon the basis of the taxpayer's annual ac-

counting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the Commissioner does clearly reflect the income. If the taxpayer's annual accounting period is other than a fiscal year as defined in section 200 or if the taxpayer has no annual accounting period or does not keep books, the net income shall be computed on the basis of the calendar year.

Gross Income Defined.

Sec. 213 (44 Stat. 23). For the purposes of this title, except as otherwise provided in section 233—

(a) The term "gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service (including in the case of the President of the United States, the judges of the Supreme and inferior courts of the United States, and all other officers and employees, whether elected or appointed, of the United States, Alaska, Hawaii, or any political subdivision thereof, or the District of Columbia, the compensation received as such), of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing

out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. The amount of all such items shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under methods of accounting permitted under subdivision (b) of section 212, any such amounts are to be properly accounted for as of a different period.

Deductions Allowed Individuals.

Sec. 214. (44 Stat. 26). (a) In computing net income there shall be allowed as deductions—

(1) All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries * * *.

(2) All interest paid or accrued within the taxable year on indebtedness, * * *.

(3) Taxes paid or accrued within the taxable year, * * *.

(4) Losses sustained during the taxable year and not compensated for by insurance or otherwise, if incurred in trade or business.

(5) Losses sustained during the taxable year and not compensated for by insurance or otherwise, if incurred in any transaction entered into for profit, though not connected with the trade or business; * * *.

(6) Losses sustained during the taxable year of property not connected with the trade or business (but in the case of a non-resident alien individual only property within the United States) if arising from fires, storms, shipwreck, or other casualty, or from theft, and if not compensated for by insurance or otherwise. * * *.

(7) Debts ascertained to be worthless and charged off within the taxable year. * * *.

(8) A reasonable allowance for the exhaustion, wear and tear of property used in the trade or business, including a reasonable allowance for obsolescence. * * *.

Net Income of Corporations Defined.

Sec. 232 (44 Stat. 41). In the case of a corporation subject to the tax imposed by section 230 the term "net income" means the gross income as defined in section 233 less the deductions allowed by sections 234 and 206, and the net income shall be computed on the same basis as is provided in subdivisions (b) and (d) of section 212 or in section 226. In the case of a foreign corporation or of a corporation entitled to the benefits of section 262 the computation shall also be made in the manner provided in section 217.

Gross Income of Corporations Defined.

Sec. 233 (44 Stat. 41). (a) In the case of a corporation subject to the tax imposed by section 230 the term "gross income" means the gross income as defined in sections 213 and 217, except that mutual marine insurance companies shall include in gross income

the gross premiums collected and received by them less amounts paid for reinsurance.

Deductions Allowed Corporations.

Sec. 234. (44 Stat. 41). (a) In computing the net income of a corporation subject to the tax imposed by section 230 there shall be allowed as deductions:

(1) All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, * * *.

(2) All interest paid or accrued within the taxable year on its indebtedness. * * *.

(3) Taxes paid or accrued within the taxable year. * * *.

(4) Losses sustained during the taxable year and not compensated for by insurance or otherwise. * * *.

(5) Debts ascertained to be worthless and charged off within the taxable year. * * *.

(6) The amount received as dividends * * *.

(7) A reasonable allowance for the exhaustion, wear and tear of property used in the trade or business, including a reasonable allowance for obsolescence.

(8) In the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case; * * *.

(9) In the case of insurance companies (other than life insurance companies), in addition to the above (unless otherwise al-

lowed): (A) The net addition required by law to be made within the taxable year to reserve funds * * *.

(10) In the case of mutual marine insurance companies, there shall be allowed, in addition to the deductions allowed in paragraphs (1) to (9), inclusive, unless otherwise allowed, amounts repaid to policyholders on account of premiums previously paid by them, and interest paid upon such amounts between the ascertainment and the payment thereof;

(11) In the case of mutual insurance companies (including interinsurers and reciprocal underwriters, but not including mutual life or mutual marine insurance companies) requiring their members to make premium deposits to provide for losses and expenses, there shall be allowed, in addition to the deductions allowed in paragraphs (1) to (9), inclusive, unless otherwise allowed, the amount of premium deposits returned to their policyholders and the amount of premium deposits retained for the payment of losses, expenses, and reinsurance reserves.

Taxes on Insurance Companies.

Sec. 242. (44 Stat. 47). When used in this title the term "life insurance company" means an insurance company engaged in the business of issuing life insurance and annunity contracts (including contracts of combined life, health and accident insurance), the reserve funds of which held for the fulfillment of such contracts comprise more than 50 per centum of its total reserve funds.

Sec. 243. (44 Stat. 47). In lieu of the tax imposed by section 230, there shall be levied, collected, and paid for each taxable year upon the net income of every life insurance company a tax as follows:

(1) In the case of a domestic life insurance company, 12½ per centum of its net income;

(2) In the case of a foreign life insurance company, 12½ per centum of its net income from sources within the United States.

Section 244. (44 Stat. 47). (a) In the case of a life insurance company the term "gross income" means the gross amount of income received during the taxable year from interest, dividends, and rents.

(b) The term "reserve funds required by law" includes, in the case of assessment insurance, sums actually deposited by any company or association with State or Territorial officers pursuant to law as guaranty or reserve funds, and any funds maintained under the charter or articles of incorporation of the company or association exclusively for the payment of claims arising under certificates of membership or policies issued upon the assessment plan and not subject to any other use.

Section 245. (44 Stat. 47. (a) In the case of a life insurance company the term "net income" means the gross income less—

(1) The amount of interest received during the taxable year which under paragraph (4) of subdivision (b) of section 213 is exempt from taxation under this title.

(2) An amount equal to the excess, if any, over the deduction specified in paragraph (1) of this subdivision, of 4 per centum of the mean of the reserve funds required by law and held at the beginning and end of the taxable year, plus (in case of life insurance companies issuing policies covering life, health, and accident insurance combined in one policy issued on the weekly premium payment plan, continuing for life and not subject to cancellation) 4 per centum of the mean of such reserve funds (not required by law) held at the beginning and end of the taxable year, as the Commissioner finds to be neecssary for the protection of the holders of such policies only;

(3) Th amount received as dividends (A) from a domestic corporation other than a corporation entitled to the benefits of section 262, and other than a corporation organized under the China Trade Act, 1922, or (B) from any foreign corporation when it is shown to the satisfaction of the Commissioner that more than 50 per centum of the gross income of such foreign corporation for the three-year period ending with the close of its taxable year preceding the declaration of such dividends (or for such part of such period as the foreign corporation has been in existence) was derived from sources within the United States as determined under section 217.

(4) An amount equal to 2 per centum of any sums held at the end of the taxable year as a reserve for dividends (other than dividends payable during the year following the taxable year) the payment of which is de-

ferred for a period of not less than five years from the date of the policy contract;

(5) Investment expenses paid during the taxable year: *Provided*, That if any general expenses are in part assigned to or included in the investment expenses, the total deduction under this paragraph shall not exceed one-fourth of 1 per centum of the book value of the mean of the invested assets held at the beginning and end of the taxable year;

(6) Taxes and other expenses paid during the taxable year exclusively upon or with respect to the real estate owned by the company, not including taxes assessed against local benefits of a kind tending to increase the value of the property assessed, and not including any amount paid out for new buildings, or for permanent improvements or betterments made to increase the value of any property. The deduction allowed by this paragraph shall be allowed in the case of taxes imposed upon a shareholder of a company upon his interest as shareholder, which are paid by the company without reimbursement from the shareholder, but in such cases no deduction shall be allowed the shareholder for the amount of such taxes.

(7) A reasonable allowance for the exhaustion, wear and tear of property, including a reasonable allowance for obsolescence.

(8) All interest paid or accrued within the taxable year on its indebtedness, except on indebtedness incurred or continued to purchase or carry obligations or securities (other than obligations of the United States issued after September 24, 1917, and originally sub-

scribed for by the taxpayer) the interest upon which is wholly exempt from taxation under this title; and

(9) In the case of a domestic life insurance company, the net income of which (computed without the benefit of this paragraph) is $25,000 or less, the sum of $2,000; but if the net income is more than $25,000 the tax imposed by section 243 shall not exceed the tax which would be payable if the $2,000 credit were allowed, plus the amount of the net income in excess of $25,000.

(b) No deduction shall be made under paragraphs (6) and (7) of subdivision (a) on account of any real estate owned and occupied in whole or in part by a life insurance company unless there is included in the return of gross income the rental value of the space so occupied. Such rental value shall be not less than a sum which in addition to any rents received from other tenants shall provide a net income (after deducting taxes, depreciation, and all other expenses) at the rate of 4 per centum per annum of the book value at the end of the taxable year of the real estate so owned or occupied.

(c) In the case of a foreign life insurance company the amount of its net income for any taxable year from sources within the United States shall be the same proportion of its net income for the taxable year from sources within and without the United States, which the reserve funds required by law and held by it at the end of the taxable year upon business transacted within the United States is of the reserve funds held by it at the

end of the taxable year upon all business transacted.

The Regulations.

Regulations 69, pertaining to the Revenue Act of 1926, provides by Article 685, subdivision (3), that—

> The deduction allowed by Section 245 (a) (8) for interest on indebtedness is the same as that allowed other corporations by Section 234 (a) (2) (See Articles 561 and 121) but this deduction includes item 18 of the disbursement page of the annual statement of life companies to the extent that interest on dividends held on deposit and surrendered during the taxable year is included therein. Dividends left with the company to accumulate at interest are a debt and not a reserve liability.